

for the rehabilitation in accordance with § 572.100(d) of a unit (whether the required rehabilitation occurs before or after the family takes title) must be not less than 20 percent and not more than 30 percent of one-twelfth of the annual income of the family used for the purpose of determining eligibility under § 572.110(a). (For the purpose of determining affordability of the family, the recipient may, at its option, adjust downward the annual incomes of eligible families using reasonable standards and procedures consistently applied.) HUD may approve a justified request for a floor lower than 20 percent to avoid undue hardship to families, such as where the cost of utilities is high.

(2) The 30 percent cap on monthly payments includes closing costs only if closing costs are included in the costs of principal and interest, or are otherwise required to be paid by the homeowner over time after acquisition.

(3) Applicants are encouraged to consider the additional monthly costs of utilities and other monthly housing costs, such as condominium and cooperative fees, in determining whether the family can afford to purchase a unit.

(b) *Continued affordability.* The recipient must develop a plan demonstrating reasonable efforts to ensure continued affordability by homeowners in the eligible property. Financing that would impair the continued affordability of the property for homebuyers, such as a mortgage that is not fully amortizing (e.g., a "balloon" mortgage) may not be used. The plan should take into account such program features as long-term financing at reasonable terms, energy conservation, and improvements that will entail low-cost maintenance.

[58 FR 36526, July 7, 1993, as amended at 60 FR 36018, July 12, 1995]

§ 572.125 Replacement reserves.

(a) *Purpose.* A single replacement reserve may be established for the homeownership program only if HUD determines it is necessary to prevent severe financial hardship to families caused by the failure of a major system or component of the property that would render the unit substandard. Initially, the reserve must be justified by the ap-

plicant and approved by HUD as part of the program budget in the application or an amended application.

(b) *Need for reserve account.* In determining the need for a replacement reserve, the applicant or recipient must demonstrate that the financial status of eligible families is insufficient to meet the needs for which the reserve is established, and that the amount proposed for the reserve is reasonable, taking into account the following factors:

(1) The size of the implementation grant and the amount of matching contributions;

(2) The availability of insurance, and the home maintenance and repair capabilities of the families; and

(3) The condition and age of the properties and each of their major systems and components (including at least the heating, plumbing, and electrical systems, the roof, foundation, windows, exterior walls, and common area, if any).

(c) *Drawdown of reserve funds.* Replacement reserve funds may only be drawn down under the Cash and Management Information System when specifically needed to assist a homeowner. At time of program closeout, all funds approved for a replacement reserve may be drawn down to fund a reserve account. The account may not exceed six years estimated replacement cost needs for the properties transferred under the homeownership program.

(d) *Administration of the reserve account.* The recipient must identify the entity that will administer the replacement reserve account at time of program closeout. The entity responsible for administering the account must be bonded and approved by HUD. The account must be interest bearing, if possible, and interest earned thereon must be used for the purposes for which the account is established. Unused funds at the end of the term of the account must be treated as program income in accordance with § 572.135(d).

§ 572.130 Restrictions on resale by initial homeowners.

(a) *Right to transfer.* A homeowner may transfer the homeowner's ownership interest in the unit, subject only

to the right to purchase under paragraph (b) of this section; the requirement for the purchaser to execute a promissory note, if required under paragraph (d) of this section; and the limitation on the amount of sales proceeds a family may retain upon sale within the first six years, as required under paragraph (c) of this section.

(b) *Right to purchase.* (1) Where a cooperative has jurisdiction over the unit, it has the prior right to purchase the ownership interest in the unit from the initial homeowner for the amount and on the terms specified in a firm contract between the homeowner and a prospective buyer. The cooperative association has 10 days after receiving notice of the firm contract to decide whether to exercise its right and 60 additional days to complete closing of the purchase.

(2) If no cooperative has jurisdiction over the unit and if the prospective buyer is not a low-income family, the recipient or a PHA/IHA with jurisdiction for the area in which the unit is located, whichever is specified in the documents under which the initial family acquires an ownership interest in the unit, has the prior right to purchase the ownership interest in the unit for the amount and on the terms specified in a firm contract between the homeowner and a prospective buyer. The recipient or PHA/IHA has 10 days after receiving notice of the firm contract to decide whether to exercise its right and 60 additional days to complete closing of the purchase.

(3) Where a recipient, cooperative, or PHA/IHA exercises a right to purchase, it must resell the unit to an eligible family promptly.

(4) Unless otherwise provided in the property transfer documents, none of the provisions of paragraph (b) of this section apply in the case of liquidation of a security interest in the property. If FHA has insured a mortgage on the property, the provisions of paragraph (b) of this section shall not apply upon occurrence of an event requiring termination under 24 CFR 203.41(c)(2) or 234.66(c)(2).

(c) *Limitation on equity interest an initial homeowner may retain from sale during first six years.* (1) The HOPE program is designed to assure that an ini-

tial or subsequent homeowner does not receive any undue profit from acquiring a unit under the program and that, to the extent the sales price is sufficient, an initial homeowner recovers the equity interest in the property. With respect to any sale by an initial homeowner during the first six years after acquisition, the family may retain only the amount computed under this paragraph. Any excess must be distributed as provided in § 572.135(b). The amount of equity an initial homeowner has in the property is determined by computing the sum of the following:

(i) The contribution to equity paid by the family (such as any downpayment (in the form of cash or the value of sweat equity) and any amount paid towards principal on a mortgage loan during the period of ownership);

(ii) The value of any improvements (not including normal or routine maintenance) installed at the expense of the family during the family's tenure as owner (including improvements made through sweat equity), as determined by the recipient or other entity specified in the approved application based on evidence of amounts spent on the improvements, including the cost of material and labor (or the value of the sweat equity); and

(iii) The appreciated value, determined by applying the Consumer Price Index (Urban Consumers) or other HUD approved index against the contribution to equity under paragraphs (d)(i) and (ii) of this section.

(2) The recipient (or other entity) may, at the time of initial sale, enter into an agreement with the family to set a maximum amount which this appreciation may not exceed.

(3) Amounts that count towards a family's equity may not also count towards the match.

(d) *Promissory note.* (1) If the purchase price of the unit (adjusted, if applicable as described in this paragraph) paid by the initial homebuyer is less than the fair market value of the property (based on an appraisal of the value of the unit after rehabilitation to applicable program standards conducted in accordance with the appraisal requirements in § 572.100(b)), the initial homeowner must, at closing, execute a non-amortizing, nonrecourse, noninterest-

bearing promissory note, in a form acceptable to HUD, equal to the difference between such fair market value of the unit and the adjusted purchase price, together with a security instrument securing the obligation of the note and recorded in local land records or other applicable system of recordation appropriate to the type of security interest being recorded. The note must be payable to the recipient or other entity designated in the approved homeownership plan. In determining the amount of the promissory note and for that purpose only, the purchase price must be adjusted by deducting all substantial amounts of financial assistance with respect to the family's acquisition or rehabilitation of the unit that would result in an undue profit to the family if it were to sell the unit at the beginning of the 7th year of homeownership. (See paragraph (c) of this section for an additional restriction on return to the homeowner on resales during the first six years.) For this purpose, "substantial financial assistance" includes all forms of assistance or subsidy from HOPE 3 resources that reduce the cash return (sales proceeds) received by the recipient for the unit below its appraised after-rehabilitation fair market value by more than a total of \$4,000, including (without limitation) discounted purchase prices, downpayment assistance, and rehabilitation or purchase money grants or loans that are not repayable on an amortizing basis. Financing to homeowners provided from HOPE 3 resources may not be assumed by subsequent homebuyers.

(2) With respect to a sale by an initial homeowner, the note must require payment upon sale by the initial homeowner, to the extent proceeds of the sale remain after paying off other outstanding debt secured by the property that was incurred for the purpose of acquisition or property improvement, paying any other amounts due in connection with the sale (such as closing costs and transfer taxes), and paying the family the amount of its equity in the property, computed in accordance with paragraph (c) of this section.

(3) With respect to a sale by an initial homeowner after the first six years after acquisition, through the 20th year, the amount payable under the

note must be reduced by $\frac{1}{168}$ of the original principal amount of the note for each full month of ownership by the family after the end of the sixth year. The homeowner may retain all other proceeds of the sale.

(4) Where a subsequent purchaser during the 20-year period, measured by the term of the initial promissory note, purchases the property for less than the then current fair market value (determined in accordance with the appraisal requirements in § 572.100(b)), the purchaser must also execute at closing a promissory note and mortgage (to be recorded as stated in paragraph (d)(1) of this section) payable to the recipient or its designee, for the amount of the discount (but no more than the amount payable at the time of the sale on the promissory note by the seller). The term of the promissory note must be the period remaining of the original 20-year period. The note must require payment upon sale by the subsequent homeowner, to the extent proceeds of the sale remain after covering costs of the sale, paying off other outstanding debt secured by the property that was incurred for the purpose of acquisition or property improvement, and paying any other amounts due in connection with the sale. The amount payable on the note must be reduced by a percentage of the original principal amount of the note for each full month of ownership by the subsequent homeowner. The percentage must be computed by determining the percentage of the term of the promissory note the homeowner has owned the property. The remainder may be retained by the subsequent homeowner selling the property.

(e) *Additional restrictions.* Notwithstanding paragraph (a) of this section, an applicant may propose in its application, and HUD may approve, additional reasonable restrictions on the resale of units under the program. HUD does not encourage additional restrictions, but HUD approval will be based on a review of the individual circumstances. However, HUD will not approve restrictions that it determines will substantially limit the ability of homeowners to realize financial appreciation in the value of their homes.

[58 FR 36526, July 7, 1993, as amended at 61 FR 48798, Sept. 16, 1996]